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Soviet Subsidies to Eastern Economies

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It is now being argued that the Soviet Union has been economically exploiting its trade partners in the Council for Mutual Economic Assistance (Comecon), particularly Poland, by using the "transferable ruble" to obtain highly favorable ruble/dollar exchange rates. In this way, it is argued, the Soviet Union is able to buy manufactured goods from its East European partners cheaply, while Eastern Europe must supposedly borrow heavily in the West to buy the machinery and material used to produce these manufactured goods. And this Soviet exploitation of East European workers and Western credit markets is said to have been used to allow the Soviets to build and maintain a vast military establishment.

The problem with the theory is that its key premise—that the Soviet Union exploits Eastern Europe through the imposition of discriminatory terms of trade—is not supported by the facts. A recent study prepared by the authors, soon to be published by the University of California Press at Berkeley, concluded that in recent years the Soviet Union has granted Eastern Europe large trade subsidies, averaging $5.8 billion during 1974-78, rising to $10.4 billion in 1979, and a staggering $21.7 billion in 1980.

Similarly, in a report before the Joint Economic Committee presented last July 8, Maj. Gen. Richard X. Larkin, deputy director of the Defense Intelligence Agency, and Edward M. Collins, vice director for foreign intelligence, said that "Soviet aid of all kinds to other Communist regimes rose from nearly $2 billion in 1971 to nearly $24 billion in 1980." In view of the empirical failure of the "exploitationist" description of Soviet policy in Poland and the rest of Eastern Europe, we are forced to look for other explanations.

The most likely motivation for a Soviet policy of economic subsidization of Eastern Europe is to obtain military, political, and ideological benefits from the Communist parties of East European countries.

Distribution Estimate

Our estimate of the distribution of Soviet trade subsidies among individual East European countries is presented in the accompanying table.

What gives rise to these subsidies? Their primary source is the price formation formula used by the Comecon countries for intra-bloc trade. Since 1975, intra-Comecon prices have been set on the basis of a lagged five-year moving average of dollar world market prices converted to rubles. For example, the Soviet export price for oil in 1980 was based on the average of world market prices during 1975-79.

Over the last decade, world market prices of energy and primary goods have been growing much faster than prices of manufactured goods. Since the Soviet Union primarily exports fuels and non-food raw materials to Eastern Europe and imports manufactured goods, the intra-Comecon price formation formula has not worked in its favor. In other words, thoughout the decade, the Soviet Union would have been better off economically if it had been able to divert its exports of energy and raw materials from Eastern Europe to the West and purchase the manufactures it needs from the West rather than from Eastern Europe.

To illustrate how Soviet Union subsidizes its trade with Eastern Europe, we'll use some examples from Polish-Soviet trade. Three key Polish import commodities, which represent 31% of Polish imports from the Soviet Union, are crude oil, natural gas and cotton. Three key Polish export commodities, which account for 13% of Polish exports to the Soviet Union, are hard coal, railroad cars and fishing trawlers.

The Soviet Union engages in preferential trade ... to sustain the allegiance of and maintain dominance over Eastern Europe's Communist parties.

Soviet Trade Subsidies to East European Countries
(in million current dollars)

Year	Bulgaria	Czechoslovakia	East Germany	Hungary	Poland	Romania	CMEA Six
1974	1081	1174	2023	877	1067	43	6265
1975	919	1097	1665	598	1027	19	5325
1976	877	1195	1786	671	1021	45	5595
1977	1015	1226	1896	645	1106	50	5938
1978	1087	1086	1914	661	897	109	5754
1979*	2000	2000	3400	1200	1700	100	10400
1980*	4100	4100	7200	2600	3500	200	21700

*Preliminary estimates.

Using data from the official Polish foreign trade statistical yearbook for 1980, we compare prices of Polish exports to the Soviet Union and to the West, and prices of Polish imports from the Soviet Union and from the West for each of the above commodities.

At the ruble/dollar exchange rate of 0.65 ruble per dollar, we found that the Polish import price for Soviet crude oil was 52% below the average import price from the West, 26% below the Soviet export price to the West for natural gas and 18% below the average import price from the West for cotton. The Polish export price for hard coal was 25% above the average export price to the West, for railroad cars 12% above and 149% above for fishing trawlers. Hence, unless one argues that the official Polish trade statistics are intentionally distorted by the authorities, for which we have no evidence, we have to conclude that Poland trades with the Soviet Union at terms far superior to these available in the West. It is the Soviet Union that subsidizes the Polish economy.

Moreover during the past two years Poland has received other Soviet economic assistance. In addition to the $6.5 billion in trade subsidies we estimate Poland received from the Soviet Union in 1980-81, it also got $0.8 billion in direct Soviet hard-currency loans, $0.5 billion in Comecon bank loans backed by the Soviet Union and $2.7 billion worth of ruble credits (equivalent to about $2.3 billion at a realistic exchange rate of 1.18 rubles per dollar). Total Soviet economic assistance to Poland, including repayable credits, amounted to an equivalent of $10.1 billion. It is hardly surprising Soviet political leaders have been demanding some political return on their "investment" in Poland.

This brings us to the question of why the Soviet Union is willing to subsidize Eastern Europe. If, as some view it, Eastern Europe is a part of the Soviet "empire," would it not be reasonable to expect that the Soviet Union maintains this empire to exploit it? We argue to the contrary. With respect to trade with Eastern Europe, the Soviet leaders seek, in addition to the conventional gains from trade, certain non-economic benefits that are military, political and ideological.

The Soviet political leadership maintains national security from a combination of Soviet troops and military hardware in the Soviet Union, Soviet troops and military hardware stationed in Eastern Europe and the allegiance of the Communist parties of East European countries. This allegiance can substitute for the direct use of Soviet manpower and hardware to provide security services to the Soviet Union. The Soviet Union is the dominant power within Comecon, and it engages in preferential trade treatment of Eastern Europe relative to the West to sustain the allegiance of and maintain dominance over the Communist parties of Eastern Europe.

In return, the Soviet Union obtains important military and strategic benefits: creation and maintenance of the Warsaw Pact military alliance, a buffer of several hundred miles between itself and Western Europe, forward military bases in Eastern Europe and proxy intervention (particularly in the case of East Germany) in Third World countries on behalf of the Soviet Union.

The Soviet Union also obtains political benefits: voting along alliance lines in international forums, informal Eastern European government and media support, and, to some extent, even the support and friendship of certain segments of the East European population. Ideological benefits have occurred primarily through acceptance of the Soviet brand of communist political ideology and its propagation to other countries.

Finally there are also some special economic benefits available to the Soviet Union in return for its trade subsidies: increased economic stability in Comecon, reduced risk of disrupted flow of strategic goods (technologically superior machinery from East Germany and Czechoslovakia) and reduced risk of refusal to purchase Soviet exports for reasons other than their price competitiveness.

Are They Better Off?

The next question is whether Eastern Europe is better off for being associated so closely with the Soviet Union. If the Soviet trade subsidies are viewed as "payment" for the loss of East European sovereignty, the answer is probably no. An independent Eastern Europe, free to restructure its internal and external economic relationships, would probably be far more productive. It is unlikely that the Soviet subsidy makes up for the low productivity of the current system. Moreover, under the conditions of Soviet "hegemony" in Eastern Europe, there is no reason for the Soviet Union to fully compensate East European countries for the loss of sovereignty because of the expected high cost of a popular rebellion in terms of human lives and property.

It is essential that Western policy makers have an accurate understanding of the nature of the economic relationship between Eastern Europe and the Soviet Union in general, and Poland and the Soviet Union in particular. Failure to recognize the extent of Soviet subsidization will only hamper Western efforts to support the Polish people's struggle to overcome their current economic problems and to reduce the degree of Soviet domination over Poland.

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